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Are « big n » always Independent? An Analysis of an Audit Restatement of the Accounts of a «Big n» Client in Cameroon

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Abstract

Big N companies, known as the biggest audit firms in the world, worldwide dominate the audit market and their network organization reinforces that dominating position. Theoretically, Big N are considered by accounting literature as more independent than others forms of audit companies. This article focuses on that issue trough the analysis of the audit restatement of a big N client in Cameroon by a fully independent organism. Using four independence threats, the results suggest the potential vulnerability of big n local offices on wasting their independence when the client represents an important part of their business revenue.

1. Introduction

The issue of auditor independence mobilizes special attention from professionals and researchers in accounting. This importance is due to financial information crisis and financial scandals, which tend to give a general discrediting to the auditing profession, intended to ensure and provide quality assurance to certified financial statements (Piot and Kermiche, 2009). Independence is a key aspect of the audit: It is described by Schandl (1978) as the essence of the audit or by Wolf (1979); Whittington and Pany (1995) as the foundation and purpose of the audit.

Given the need of ensuring independence, accounting literature has developed indicators that can serve as a reference or basis for the assessment of the level of impartiality of the auditor. Past works conclude that the large size auditors (the big 4 now become big n after the bankruptcy of the US giant Arthur Andersen) are more independent than other auditing firms (Moiser, 1997). The large number and diversity of customers (De Angelo, 1981) of large auditors create in them a need of good reputation that makes them maintain their independence, and leads them to produce better quality audits (Copley, 1991 ; Clarkson and Simunic, 1994; Becker et al., 1998; Bauwhede et al., 2000; Zhou and Elder, 2001; Piot, 2004; David et al, 2006). This stance, though shared by several authors, has several weaknesses. Pigé (2003) points for example out that the size is not necessarily a guarantee of independence, since differences in accounting and auditing practices may exist between headquarters and local representatives of major audit networks. The case of the failure of Arthur Andersen is also a criticism of the argument size. This event showed the relativity of this argument (Manita, 2009) and, combined with convictions by regulatory agencies, some large networks like KPMG sanctioned in January 2014 in the US by the SEC for «lack of independence, "reopens the question of the independence of the a priori acquired l for large audit firms.

This work comes at a contribution to the debate by looking at the case of a big n Cameroon. Work on independence in relation to the auditor's size will be presented (1). This literature review will lead us to the observation of case of auditing firm KPMG in its auditor tasks of a state-owned company, the national society of Cameroon refinery (SONARA), and analysis of the implications of this case from the four major threats to independence considered by the literature as incorporated by Lin and Téplagul (2009) namely financial dependence, audit tenure, auditor affiliation with certified public accountant firms, and non-audit services. Finally, a presentation of the study results and their discussion will end this article.

2. The size of the auditing firm, an indicator of its independence

This part will deal with prior literature that connects auditors' independence and auditor's size. The idea that emerges and seems to create acceptance of a significant part of theorists refers to the existence of a strong relationship between the size of an auditor and its ability to remain independent (1). This posture can still following certain circumstances be called into question (2).

2.1 Auditor size and Auditor's Independence

The external auditor's size is a particular concern in auditing in that it favors, according to the findings of several authors, the perceived independence of the auditor. Perceived independence because all indicators are a priori gathered for the audit to be good. In general, larger firms have human and material resources and they develop very robust buddy systems to minimize agency problems (Watts and Zimmerman, 1986; Francis and Wilson, 1988; Johnson and Lys, 1990; Firth and Smith, 1992 cited by Manita, 2009). Thus, a strong relationship is measured between the absence or low levels of problems and agency costs in some companies and the size of their audit firm. Major audit networks have tendance to issue more often reserves than small firms (Leennox 1999). As a result, companies undergoing the higher agency costs have a greater tendency to engage with major audit networks.

Although the use of an external auditor is a legal requirement in some environments, it is also used as a signal by business leaders in search of a market reaction to the publication of annual accounts. Studies conducted have shown for example that the market reacts more positively to the announcement end of year financial results when a company goes from a small auditor to a larger, that when a company goes from a great to a smaller auditor (Nichols and Smith, 1983; Eichenseher et al. 1989).

According to the study of Barizah Nur (2009), size is the first criterion of independence. Large firms have more guarantees in terms of financial sensibility, by their ability to pool in their risk of losing a client. The big audit networks have a large and diverse number of clients, which limits a possible financial dependence on one of them, which is not the case for small auditors (De Angelo, 1981). The risk of compromising the independence to safeguard a client that may be crucial to the auditor's survival is much higher in small firms. Investors perceive then audit services of the big networked auditors as superior to isolated ones, including in terms of independence (De Angelo 1981 Shockley 1981 Gul and Tsui, 1992) and their reports are estimated as more reliable (McKinley , and Reckers Pany, 1985).

Moreover, large audit networks had much more to lose in terms of reputation than local auditors, if they sacrifice their independence, and their name is mentioned with accounting fraud cases (De Angelo, 1981; Watts and Zimmerman, 1986). Kreps (1990) estimates that confidence in the auditor is built in reference to a reputation. The quality of financial statements of a company audited by a big n was also considered. Becker et al. (1993) measured a strong relationship between the size of the auditor and the reduction of discretionary accruals of the company's accounts, suggesting a better result for companies audited by a networked auditor.

This overall position of the accounting literature can also explain the rise and sovereignty that big n occupy today in the different auditing markets. Networked auditors have better perceived guarantees of competence and independence compared to out networked auditors. The international nature characterized by belonging to a large network, the index size in this perspective, is perceived by investors and the market as a signal of independence and audit quality. This position may nevertheless admit some criticism.

2.2 Auditor Size and auditor's independence: theoretical and historical controversies

The aforementioned works seem to have omitted an important part of the auditor's large size as mobilized, particularly international networked organized auditing firms. This network provision, for the overall quality and level of independence be generalized to the entire network, must be able to suggest a homogenization and standardization of certification practices within each network, that is to say from the Office headquarters to all its local representatives. The loss of a client for a network can for example be a small part of its overall turnover, but a very important part locally. In this case, if control rules for the entire network are not strictly enforced, there is a risk that local representation adopts behaviors that may damage its independence. According to Pigé (2003), network independence assumption is based on another assumption, which is that of the internal consistency of each auditor. If this assumption of homogeneity is not verified, the correlation assumptions between auditor's size and auditor independence become meaningless (Manita, 2009).

Historical events that occurred in the early 2000s have also questioned the positioning of the literature on the large audit firms, including the failure of Arthur Andersen following the Enron case. The spectacular fall of this international network has raised, among both practitioners and academics, many questions about audit quality control and supports the idea of redefining more reliable valuation rules. At times, this international network was ranked first worldwide network by its turnover in audit but mostly, it was the quality of his performance or simply its reputation. The reputation and size of the firm have been used by many researchers to be reliable indicators of the quality of audit work (Manita, 2009).

One can add to this historic event, all recent cases (January 2014) of KPMG in the US sanctioned by the Securities and Exchange Commission for "lack of independence", following the provision of certain non-audit services regularly prohibited by the regulation. These facts combine with the incompleteness of the literature on the issue, which is, according to Chemangui (2004), no convincing evidence of a higher opinion of quality among large firms could be provided by the prior literature given the methodological and conceptual difficulties of such an undertaking.

This state of affairs calls back for the agenda the question of the independence of the auditor in relation to its size. This work will therefore try to contribute to this debate by looking at the case of a "restatement" of a big n client audited accounts, KPMG, by totally independent controllers. Total dependence refers here to the lack of financial connection (payment fees) between controllers and management, and the lack of a contract relationship between the two parties (the selection of independent external auditors does not depend on the direction of the audited company).

3. Context of the study

The observation of the phenomenon of independence is strongly linked to the context, independence is itself linked with audit requirements, and the existence of a chartered accountants association (ONNECCA in Cameroon)... The study context should be presented to describe the local audit market and its opportunity for the issue at hand.

3.1 Cameroon audit market: A representation of the international market

The audit market in Cameroon is experiencing significant expansion, with the arrival in the sector of several new comers offering services as diverse as those offered by the older ones. The offer is thus structured around the former functions of the external auditor as statutory audit or accounting expertise in our context. Alongside this traditional mission of the external auditor, several other services are offered, advancing the offer to the international modernity (Casta and Mikol, 1999). Those of them that come up most often are related to the accounting and management assistance, internal control, taxation or so human resources.

Demand however has a strong tendency to focus around the statutory auditing services. In a fiscal environment predator like that of Cameroon (Ngantchou, 2009), the statutory audit appears to be an essential tool of governance. On the other hand, management advisory services seem very expensive for an economy made up over 90% of small and medium enterprises.

Like international auditing market architecture, auditing in Cameroon is dominated by international networking companies, big n. According to the 2013 ONNECA report the big n auditors have the lion's share in the local audit market. The strong presence of major audit networks, coupled with the return of others like Ernst and Young three years ago, show the attractiveness of the sector and its dynamism. The audit of multinational companies and some international investment and cooperation programs consolidate that domination. The networked auditors enjoy therefore reputation as a major asset that can explain their leadership on the Cameroonian audit market.

3.2 The Cameroonian context of «Restatement": The SONARA case

In the various reports by Transparency International, Cameroon spurred from 2000 to 2012, the bottom of the ranking of corrupted countries, according to an index calculated from corruption perception indicators measured on a global scale up to 10 2011 and 100 in 2012. To improve this score and the fight against corruption, the government has undertaken a vast operation "rechecking" accounts of public institutions and administrations known locally under the name of "operation épervier "by external and independent auditors, under the responsibility and supervision of an independent body which is the budgetary and financial discipline board. It is in this context that the verification process occurs on SONARA accounts, audited for the period (2007-2010) by two co-auditors, the firm K & Co., a big n company, KPMG. The operation of "rechecking" (restatement) also occurs in a context where the national society of Cameroon refinery (SONARA) has a financial health lackluster due to soaring oil prices on the international market, and grants increasingly untenable that the state agrees to limit the effect of this surge at the pump price, enlisting the help of the refinery company

4. Methodology and Results

To try to answer the research question, the operation of "rechecking" accounts was considered timely. The literature traditionally ranks under the dome of dependence the fact that auditor receives his fees from the management of the audited company, which is also in charge of his selection - dismissal.

4.1 Precautions and methodological approach

The state controllers presented the advantage of not being dependent of the direction of SONARA for any of the above mentioned conditions of dependency. Their salary and their recruitment was decided by an independent body, the budgetary and financial discipline board itself hierarchically attached directly to the ministry in charge of higher state control. It is therefore possible to apply their full independence at the time of the audit. It is also possible to add the context of their mission (inspectors in charge of the fight against corruption), which limits a priori the risk of being influenced by SONARA management aware of that mission.

The profile of the title of "controller" or state inspector as they are called locally has been reviewed to ensure, from consensual competence characteristics of literature (Flint, 1988; Fama and Jensen, 1983) that they had the necessary profile to ensure their competence. Having been trained in an elite school in Cameroon (ENAM) in accounting and finance techniques, as well as administrative and legal technologies seems to give them the skills profile required. Their management experience and the well-structured organization they belong to reinforce these skills.

The texts of higher state control court governing the action of its controllers were then screened to ensure that significant objective differences do not exist with those of the statutory audits. To compare the results obtained separately, it is indeed necessary that the objectives and procedures are comparable. The insistence of higher state control texts on compliance with the law through any kind of accounting caution governing the operations was used to establish substantial similarity. Verify the reliability and fair view of the accounts being in the case of statutory auditors as in the case of rechecking, the objective of the mission.

At the end of their mission, the auditors of the Budget and Finance Disciplinary Council have revealed anomalies in the accounts of the national refinery company for the period from 2007 to 2010, while over the same period, KPMG, big n considered, had certified the accounts. The financial damage suffered by SONARA due to the auditor KPMG and its Joint Statutory Auditors K and Co., would amount, according to independent monitors, three billion six hundred nine million three hundred and eighty seven thousand two hundred and nineteen (3 609 387 219) CFA Francs. As financial discipline, a fine was imposed at KPMG in these terms: "The Council has decided, within the limits of its powers as defined by organic laws, to impose a special fine of two million (2000 000) CFA francs to each of KPMG Cabinets and K & Cie Co-Auditors of that company, individually, for all management errors committed by them in the context of that case".

4.2 Breach of KPMG: A question of independence?

KPMG's independence can it be questioned for the study period considered? Note that the head of the company for the period was considered guilty of serious management errors that led to a lawsuit against him and his conviction. This leaves clear that the accounts contained significant anomalies that the audit did not disclosed. By sticking to the definition of independence as an anomaly revelation exercise (De Angelo, 1981), we can assume that in the case of KPMG, there was indeed a problem of auditor independence. The multiannual character of the period reinforces this position. This implies that over three years the Co-auditors have failed to disclose certain anomalies that have visibly affected the management of the company. The issue of certification of accounts over three years, was it with reservations, while abnormalities in the management persist, an offense due to the independence of the contracted auditors

4.3 Analysis and Implications

To analyze the case in the study, part of the main perceived threats to independence of the auditor as presented by Lin and Téplagul (2009) will be used. The implications are thus freed to improve understanding.

4.3.1 The main threats to independence according to Lin Téplagul (2009)

Lin and Téplagul (2009) reviewed publications related to auditor's independence. The article they published to this effect identifies four main threats to auditor's independence. The first relates to the importance of the audit client may have in the auditor's portfolio. The risk of compromisinf independence being here with the fact that the auditor, given the significant financial weight occupied by a company in its client portfolio and therefore coating or less the survival of the organization, will be tempted to conceal any anomaly discovered during the audit, or at best mitigate it, protecting the life of the audited company and starting his. The financial dependence is inevitable, the auditor's remuneration getting from his client (De Angelo, 1981). When from that compensation depends the survival of the auditor or when so auspicious growing economic gains for him, there are great risks that it acts on behalf of the client (Blay, 2005). To work around this situation, the authors focused on the risk of litigation arising between the auditor and stakeholders and regulators after the mission. They argue, in fact, the idea that the high risk of litigation would decrease the likelihood that the auditor works in favor of the customer (Farmer, Rittenberg and Trompeter, 1987; Schatzberg and Sevcik, 1994). In case of audit failure in reality, the auditor may be subject to legal proceedings by investors, stakeholders or even the regulatory agencies or control of the profession, such as the Chartered accountants. If such events were to occur, the auditor's reputation would take a serious blow, and the he is likely to lose the remaining number of clients (De Angelo, 1981). Therefore the risk of litigation in a mission is an incentive for the auditor to remain independent despite economic dependence.

The second independence threat identified is auditor tenure. It can be considered that a higher auditor's tenure translates certain "warmth" of its relationship with its client company. This posture is still with what Bazerman, Morgan and Loeweinstein (2003) call "Through personal interest", which reflects the inability of the auditor to be independent. According to them, he is closer to the managers he knows better with time, rather than anonymous users it does not know, so sometimes unconsciously, will not defend their interests. However, opinions are divided on this point. Shockley (1981) reports such as auditor's tenure beyond five years are not perceived as significantly reducing the auditor's independence. Deis and Giroux (1992) think that audit quality is inversely proportional to audit tenure, and therefore the more it lasts, the more low quality

The potential affiliation of clients with certified public accountants is also a risk of compromising auditor's independence. It is difficult for an auditor to keep his independence from former colleagues became executive officers of the auditee, or to remain independent in front of a company that offers him a job. The proximity with management can create a parallel distance with business owners who are the real employers of the auditor and the audit team would have difficulty maintaining its independence in dealing with former colleagues (Imhoff, 1978).

The impact of non audit services is as Lin and Téplagul (2009) said the most studied of perceived independence threats. The risk that the auditor's independence may be damaged when it advises his client at the same time is great. It thus contributes to audit the accounts for the establishment of which he has participated. Levine and Kornish (2004) believe that the higher the level of consulting, the more the relationship between the auditor and auditee becomes dangerously friendly. Dopuch and King (1991) indicate that restrict an auditor to provide both audit and advisory services does not lead to efficiency gains, but may cause auditors to choose advisory services rather than the audit. Similarly, Barkess and Simnett (1994) tested the relationship between consultancy and audit fees. The research has been done on a large sample of Australian audit firms from 1986 to 1990. Each year, between 371 and 466 of the 500 largest companies were drawn from the sample, for a total of approximately 2094 observations. Using linear regression analysis, the authors rejected the null hypothesis that there is no relationship between the provision of non audit services and audit fees. Laws such as SOX in its section 201 prohibit certain types of advice. Their impact on the independence is controversial, and a key aspect audit quality.

4.3.2 What are the implications for the considered case?

The difficult access to information in our context has forced the work to be limited to the level of analysis. Previously stated threats have been reconciled with the case under consideration.

Financial dependence is the first threat of independence which may have had a decisive effect on the case. One of the criticisms leveled at large as a factor of independence is related to the probability of vulnerability of the local office of a large network (Pigé, 2003). So while KPMG is a giant of the audit, it is possible that its local representation could be in a situation where SONARA was an important and indispensable part of its turnover. The environment generally little contentious is a less instigator of independence (Farmer, Rittenberg and

Trompeter, 1987; Schatzberg and Sevcik, 1994), in that the reputation of the auditor is less likely to be tainted because of absence of litigation following an audit engagement.

"Control" covering the period 2007-2010, three-year contract between the parties, without taking into account the fact that the signature of the contract could date from before the date of "rechecking". It is possible to postulate that KPMG already had a basic knowledge of the company and its operations. It could be noted an improvement in SONARA balance sheet in 2007, total assets increased from 32 446 million in 2007 to 59,023 million in 2008, representing 54.97% growth. Over the same period, shareholders' equity will evolve to 69.59%. If we stick to the theoretical framework of perceived threats of Lin and Téplagul (2008), with the experience due to audit tenure, auditing tends to gain in quality (Johnson, Khurana and Reynolds, 2002; Maxwell and Miller, 2004), and the good results of the company over the period of the study would show its welfare and the good quality of the statutory audit carried out. The non-disclosure of anomalies appears to be an additional obstacle to the independence of statutory auditors of the considered company.

The threat of potential employment is less observable, even at the prior study on auditor independence (Francis, 2004). Otherwise, non-audit services are a key element. For the study period under review, KPMG has been a trusted advisor to the company, at the policy control losses that includes quality management, management of human resources, or improved performance at the level of losses control. Advisory services are considered by the literature as a motivation for the auditor in front of abnormality in the accounts, to rule in favor of management, to protect the fees related to its non-audit services. Providing advice would therefore have been a motivation for not revealing the anomalies discovered and revealed in "rechecking" for KPMG. The thesis of the importance of the company for the local office of the American giant, seems to be favored here, given the turnover of SONARA in 2008 (787 768 million) and operating income (43 516 million CFA).

5. Conclusion and Discussion

Auditor's independence is now a key part of the accounts verification or external auditing in general. The motivations for opportunistic behavior of the auditor necessitate refinement together legal mechanisms of control, and also research in the field. Accounting literature has considered the international auditors (big n) as models to follow or imitate for auditor's independence issues. Criticism from Pigé (2003), coupled with the historical failure of a large auditing firm Arthur Andersen underlined the necessity to further research on the issue. From the analysis of a case of "rechecking" accounts for a big client n Cameroon, assuming the risk of loss of independence for networked auditor when its client is an important part of its local revenue, or represents one of its major clients, this hypothesis seems to be supported. The analysis thus reveals, after the analysis from four perceived threats to independence studied, that it is possible that KPMG could jeopardize its independence to enjoy the benefits of its advisory position, or its audit tenure as auditors.

The analysis, however, has some limitations: It is based on a comparative analysis with theoretical considerations borrowed to Lin and Téplagul (2009). So the facts have not had a strong impact on this work. It would be interesting for future research work, to analyze cases of failure audit of large accounts verifiers using the figures and compared data from the financial accounts of the stakeholders, in terms of the amount of the advisory services, or their proportion in the turnover of theauditor. Another avenue of future research would be to examine the issue through the study of two cases of big and not big n auditor exercising in the same environment, to understand the protections and guarantees of the auditor's independence and the way in which the actors mobilize these guarantees during an actual audit mission.

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